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Pursuant to Protective Order, PR Docket No. 94-105**

stantially over a single four-year period, this would not imply a lack of competition. Shares in a highly competitive market may be stable if no firm in the market achieves a new advantage relative to competitors.

9. In any event, the CPUC has misrepresented the facts in alleging that market shares were stable during the period between 1989 and 1993. The CPUC asserts that, for each facilities-based cellular carrier, "the Sacramento MSA, San Diego MSA, and Los Angeles MSA exhibit relatively stable market share, implying equilibrium in market share for the duopolists in each of the markets studied" (CPUC Petition at 29). In fact, however, the unredacted data reveal that the sales shares of the two facilities-based carriers in four of the six MSAs studied by the CPUC changed considerably. In the share of percent in 1989 to percent in 1993, in the share of percent to percent, in the share of percent to percent, and in the share of percent to percent (CPUC Petition at Appendix E-6 and E-7).
10. Clearly, the unredacted data on market shares do not support the CPUC's assertions regarding stability and equilibrium in market shares "in each of the markets studied" by the CPUC (CPUC Petition at 29). Indeed, it would be difficult to reconcile the substantial changes in shares observed in several of the markets with an allegation that cellular carriers were not competing to expand sales.

III. Reseller Shares of Retail Sales

11. The CPUC petition presents data indicating that the retail sales shares of cellular resellers declined between 1989 and 1993, and suggests that this trend implies increasing exercise of market power by facilities-based carriers (CPUC Petition at 30-34).
12. The CPUC appears to believe that it can reduce prices to consumers in markets for mobile communications services by implementing policies that increase the share of retail sales made through independent resellers. This ar-

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gument is fundamentally incorrect. To reduce consumer prices, a regulatory policy (other than direct retail price controls) must increase capacity and output in the market. Resellers do not add capacity to the market. Regulations aimed at "protecting" resellers are likely to reduce returns for CMRS carriers, deter investment, and hence reduce capacity below the levels that would result from market forces. These regulations are also likely to increase the real costs of marketing cellular services. As a result, the CPUC's regulations are likely to increase prices to consumers.

13. The CPUC is concerned that cellular carriers have an incentive to limit the ability of resellers to compete in retail sales. To see why the CPUC's policy concern is misplaced, assume for purposes of this discussion that the carriers are not regulated and enjoy market power, and that independent resellers could perform an important competitive role in marketing mobile communications services. Even in these circumstances, the carriers would have no reason to engage in the behavior that the CPUC fears. The assumed market power of carriers would not be enhanced by the practices feared by the CPUC. Unless carriers were the least-cost providers of relevant services, they would not increase their profits by vertically integrating into retail marketing or by requiring resellers to purchase bundled services. If the carriers attempted to squeeze resellers that could play an important competitive role in marketing their services, or that could perform services at lower costs, this would increase the costs of providing services to consumers and reduce the quantity of mobile communications services sold, reducing the carriers' profits.
14. The CPUC has suggested that a declining share of resellers in retail sales indicates that competition has been declining. However, the share of resellers has no particular implication for competition. A McDonalds franchisee does not compete with McDonalds the franchiser, and the market share of independently owned McDonalds outlets, vis-à-vis company-owned stores, sheds no light whatever on the degree of competition faced by McDonalds. Furthermore, the market share of independent resellers has no direct implication for consumer well-being. In some markets suppliers are vertically-in-

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tegrated into retailing, in some they use dual distribution systems and sell to consumers both directly and through independent resellers, in others they sell only through resellers, and in some markets some suppliers use one of these organizational forms and others use another. All these options are compatible with competition.

15. Furthermore, there is an inaccuracy in the data presented by the CPUC. The petition states with regard to the Los Angeles and San Francisco Bay Area MSAs that "At the end of 1993, resellers in the two markets combined had a little less than percent market share" (CPUC Petition at 30). In fact, the reseller share of sales for the two MSAs combined in 1993 was percent, according to the unredacted data (CPUC Petition at Appendix J-1, J-4, J-7, and J-11).
16. The CPUC petition asserts with regard to declining reseller shares of retail sales that "If these trends continue, competition from resellers may disappear altogether, leaving wholesale carriers as the sole providers in given markets" (CPUC Petition at 30). However, the unredacted data indicate that the decline in the share of cellular resellers between 1989 and 1993 resulted primarily from the fact that the number of customers of resellers did not increase as rapidly as the number of customers of facilities-based cellular carriers. While the number of reseller customers in declined somewhat after reaching a peak in 1990, the number increased between 1989 and 1993.² In the number of reseller customers increased from in 1989 to in 1993 (CPUC Petition at Appendix J-7 and J-11). The declining shares of resellers clearly do not justify a general conclusion that resellers are disappearing.
17. In addition to its argument based on the combined retail share of resellers, the CPUC presents two other arguments in support of its conclusion that the allegedly limited competition that exists at the retail level is disappearing. First, the CPUC presents an argument based on the combined shares of the

² There were reseller customers in 1989; in 1990; and in 1993 (CPUC Petition at Appendix J-1 and J-4).

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facilities-based cellular carriers. Second, the CPUC presents an argument based on the Herfindahl-Hirschman Index (HHI) of concentration (CPUC Petition at 31-34). These arguments are circular and misleading. The CPUC *assumes* that “there is no significant competition” between facilities-based cellular carriers, and that they can therefore be treated as a single firm. However, the CPUC has presented no valid evidence that the two facilities-based carriers do not compete. It is circular to base a conclusion that competition in a market is limited on an assumption that the two largest suppliers do not compete. Contrary to the CPUC’s assertions, the retail market shares of facilities-based carriers and retail HHIs do not demonstrate that relevant markets are not operating competitively. Furthermore, these two arguments add nothing to the CPUC’s analysis, because they duplicate the CPUC’s analysis of trends in the retail shares of resellers. If the combined share of resellers goes down, then obviously the combined share of facilities-based carriers goes up, since the two figures add up to 100 percent.

IV. Alleged Underutilization of Capacity

18. The CPUC argues that the facilities-based cellular carriers underutilize their capacity, and that this alleged underutilization demonstrates that they are exercising market power (CPUC Petition at 51-54). The premise for the CPUC’s analysis is that operation below maximum capacity is inconsistent with competition. The CPUC argues that “Basic economic principles dictate that when excess capacity exists, prices in a competitive market should drop” until the excess capacity is eliminated.
19. The CPUC’s position makes no sense. The CPUC has confused the concepts of *economic* capacity and *physical* capacity. Full economic capacity utilization generally takes place at a level of output significantly below full physical capacity. The CPUC’s reasoning would lead it to conclude that any industry that did not operate three full shifts at least part of the time was behaving anticompetitively. But unit costs are often lower when capacity is used only half the time than when capacity is half as large and used all the time. In short, investment in physical capacity in excess of normal operating output may be efficient and can be expected to occur in competitive industries.

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20. The CPUC's definition of the capacity of a system is based on an arbitrary rule of thumb about the probability that calls will be blocked. The CPUC has produced no evidence that the assumed probability of blocking is in any way related to the level that would prevail under competition. In fact, competition would not produce the same probability of peak period blocking everywhere, as the CPUC assumes. For a given allocation of spectrum, the efficient quality of service will depend on capacity costs, operating costs, demand for air time, and demand for higher quality of service. Since these determinants of the efficient quality of service will vary among MSAs, systems and cells, the efficient levels of service quality and capacity utilization will vary among MSAs, carriers, and cells within an MSA. This variation is what one observes in the unredacted data in Appendix M.
21. In addition, the data in the unredacted version of the CPUC petition reveal that the CPUC has misused data on capacity utilization even as that concept is defined by the CPUC itself.
- a. The CPUC states that in _____ the share of _____ cell faces in which the capacity utilization rate was 65 percent or lower "remained essentially the same" between 1990 and 1993 (CPUC Petition at 52). In fact, the unredacted data reveal that the share actually fell from _____ percent to _____ percent. Moreover, the average capacity utilization for those cells increased from _____ percent to _____ percent (CPUC Petition at n. 41 and Appendix M-2).
 - b. The text of the CPUC petition fails to point out that in 1993 the _____ percent of _____ cell faces that had a capacity utilization rate exceeding 90 percent had an average capacity utilization rate of _____ percent. (*Id.*)
 - c. The CPUC states that "in the San Francisco MSA, _____ percent of cell sectors are underutilized, with a capacity utilization rate of less than 80 percent" (CPUC Petition at 53). An accurate description of the data is that _____ percent of cell sectors had capacity utilization rates of less

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than 90 percent (not 80 percent), and only percent had utilization rates of 65 percent or less. (*Id.*)

22. In summary, the unredacted data reveal that the CPUC's factual assertions regarding capacity utilization are inaccurate and misleading. In any event, the CPUC's attempt to draw inferences regarding the exercise of market power from its measures of capacity utilization reflects a profound misunderstanding of competitive markets.

V. Conclusion

23. The CPUC has not demonstrated the existence of any problem relating to the competitive performance of cellular providers, much less any problem that would warrant the high costs of regulating CMRS rates. The unredacted data do not change my conclusions or the analyses underlying them. Therefore, I continue to conclude that the Commission should not grant the CPUC's petition.
24. It is apparent from the unredacted data that the CPUC petition suffers from inaccurate and misleading use of data. This reinforces my October 19, 1994, conclusion that the CPUC's performance in this proceeding undermines its arguments in support of continued rate regulation and casts doubt on the adequacy of its tools for administering a sensible system of CMRS regulation.

I declare under penalty of perjury that the foregoing is true and correct.

A handwritten signature in black ink, appearing to read 'B. Owen', is written over a horizontal line.

Bruce M. Owen

February 24, 1995

CERTIFICATE OF SERVICE

I, Kecia Boney, do hereby certify that on this 24th day of February, 1995:

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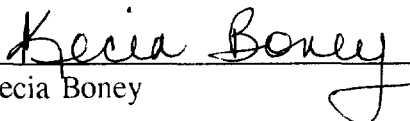
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